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IN THE

Supreme Court of the United States

October Term, 1950.

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No. 631

CONSUMER-FARMER MILK COOPERATIVE, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit and Supporting Brief.

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CONSUMER-FARMER MILK COOPERATIVE, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable Fred M. Vinson, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

Your petitioner respectfully prays that a writ of certiorari be issued to the Court of Appeals for the Second Circuit to review the judgment of that Court.

Statement of Matter Involved.

By this petition review is sought of the claim for tax exemption made by the petitioner on the basis of its dedication to the improvement of conditions in the milk industry. The petitioner has contended that it is a tax-exempt "civic organization" within the meaning of section 101(8) of the Internal Revenue Code; but the Court of

Appeals, by judgment entered December 27, 1950, affirmed a decision of the Tax Court, entered Setember 13, 1949, denying such exemption and sustaining deficiencies in the petitioner's excess profits tax and declared value excess-profits tax for the fiscal year ended September 30, 1943, in the respective amounts of $23,821.32 and $439.41.

Summary of Facts.

These are the main facts as found by the Tax Court (R. 4-13), with additions from the original transcript (Tr.):

Petitioner is a non-stock cooperative corporation under the laws of New York, and operates a milk business in conjunction with its efforts to improve the milk industry for the benefit of both the farmers and consumers in the area of the City of New York. It has no stockholders; but any person may become a consumer member upon the payment of a 25 cent membership fee; and members of farmers' associations from whom the organization purchases commodities also become members upon the payment of a like fee. The very purpose of organizing the petitioner as a cooperative was to stimulate the interest of the public in milk problems through the cooperative movement (Tr. 85). In this way membership could be made available to anyone on unlimited terms, without stockholdings (Tr. 77); and the public, which was responsible for petitioner's existence and would continue to be responsible for its support, could maintain control of the election of its board of directors (Tr. 84).

Petitioner was an outgrowth of the Milk Consumer's Protective Committee, which had been formed in 1936 primarily by a group of welfare organizations to protect the public's interest in milk distribution and milk regulation.

The need for such a committee was obvious. This Court has long recognized that the milk industry is affected with a public interest. *Nebbia* v. *People*, 291 U. S. 502. That case dealt with milk control legislation, by way of justification wherefor the New York legislature said:

> "It is hereby declared that unhealthful, unfair, unjust, destructive, demoralizing and uneconomic trade practices have been and are now carried on in the production, sale and distribution of milk and milk products in this state, whereby the dairy industry in the state and the constant supply of pure milk to inhabitants of the state are imperiled. That such conditions constitute a menace to the health, welfare and reasonable comfort of the inhabitants of the state." N. Y. Laws of 1933, Ch. 158, §300.

The 1937 report of the New York State Attorney General, in the record as Exhibit 7, is further evidence of the public outcry against practices rampant in the milk industry.

This was the atmosphere in which the Milk Consumer's Protective Committee was formed. It directed itself principally to the goal of eliminating the spread between the farmer's price and the cost to the consumer, both by raising the farmer's return and lowering the retail price. In this connection it worked for the repeal of minimum retail price fixing provisions in the New York law, participated in investigations into simultaneous price increases by the major distributors, and studied and published findings on the lack of justification for the premium charged for Grade "A" milk offered to consumers in the New York City area. It also studied the problem of underconsumption of milk.

By November 1937 the Committee represented more than 60 civic, welfare, labor, religious, consumer, and farmer organizations with a membership of almost one million people. At a meeting of the Committee called at

that time it was decided that the objectives of the Committee could be best accomplished and advanced by the creation of an active milk distributing company operating in the interests of the public, which could actually achieve a minimization of the price spread between the farmers and consumers it served, and which could serve as a yardstick for prices and practices in the industry generally (Tr. 85-86, 138). Therefore, the petitioner was organized to take over the work and activities of the Committee. Testifying to this at the trial were such of petitioner's organizers as Helen Hall, leading social worker, Mildred Gutwilig, outstanding educator and welfare worker, and also two cabinet members in the administration of Mayor Fiorello H. LaGuardia, a director of the National Farmers Union, and a churchman.

The petitioner's milk business is operated to return a reasonable profit which, after reserves, is devoted both to the civic work of the organization and to the payment to the consumer and farmer members of patronage dividends. The petitioner's works in achieving reforms in the milk price structure have included: a study and campaign leading to the elimination of Grade "A" markings on milk sold in the New York City area; a program to discourage the purchase of so-called "high-test" milk, as economically and nutritionally unsound; opposition to minimum retail price-fixing provisions in the state and federal laws, as tending to destroy competitive conditions; continuous reexamination of and giving of testimony in regard to adjustments in the complex price formulas used to fix the blended price of milk to be paid to farmers; constant checking of the commodity markets for evidence of rigging in the prices of butter, cheese, skim milk powder, etc., and the reporting of such practices to the appropriate governmental authorities; demonstration by its own experience of the unreasonableness of the premium charged for milk in "paper" containers, as compared

with milk in bottles; a study and campaign to eliminate the premium charged for "homogenized" milk, which has included the presentation of statistics to the Department of Health and the education of the public through pamphlets; adoption of a price policy, which is unique in the industry, of passing on to special types of purchasers, such as settlement houses, churches, and similar community service organizations, economies resulting from the volume and type of service required by such purchasers.

There are other ways in which the petitioner acts as a useful public servant. It works to increase milk consumption in the community generally, and especially in the low income areas, by serving "milk stations" at health clinics for poor families, and at low-cost housing developments. It has participated in subsidized school milk programs; and during the last war it serviced a navy yard and started a stage door canteen milk program. It carries on an extensive educational program concerning the milk industry for farmers and consumers, including: the distribution of its own publications and the reprinting of literature prepared by other groups; such activities by its officers and directors as lecturing at schools and colleges, appearances on the radio, and contributions of articles to farm journals; and financial support of the educational programs of affiliated organizations.

At this juncture, it is pertinent to call attention to the inexplicable lapse of the Court below when, in determining whether the petitioner was "operated exclusively for the promotion of social welfare", it simply balanced the costs of petitioner's educational program against the amount of patronage dividends it pays out (R. 40-41). The Court completely ignored the petitioner's numerous activities found by the Tax Court, and which are recounted above, in matters affecting prices and practices in the milk industry, which is far and away the most significant aspect of petitioner's civic work.

The payment of patronage dividends to consumer and farmer members is itself one form of implementation of the petitioner's basic objective of eliminating the spread in the milk price structure, by increasing the price paid to the farmer while concurrently lowering the ultimate cost to the consumer. For the sake of brevity, description of the mechanics of petitioner's patronage dividend policy is deferred until the discussion in the brief of its legal effect, *infra*. In actual practice only a negligible portion of the consumer dividends are claimed, and the unclaimed amounts are ultimately added back to surplus. In the determination of petitioner's tax liability for the taxable year, the Commissioner allowed a deduction from net income on account of patronage dividends paid to members.

Jurisdiction.

The jurisdiction of this Court is invoked under section 240(a) of the Judicial Code. Judgment was entered herein by the Court of Appeals on December 27, 1950 (R. 43). Petition for rehearing was not filed.

Opinions Below.

The opinion of the Tax Court, printed in full herein (R. 3-18), is reported at 13 T. C. 150. The opinion of the Court of Appeals, printed herein at R. 36-42, is reported at 186 F. 2d 68.

The opinions below form a variegated pattern of attacks on the petitioner's claim to exemption from tax. The principal ground of attack by the Commissioner was that the petitioner is a competitive commercial organization operating a business to make a profit. Both the Tax Court and the Court of Appeals expressly rejected this argument (R. 13, 39). The Tax Court made as the principal ground

for decision its conclusion that the surplus of the petitioner belonged to the members (R. 15). This conclusion was so obviously contrary to the normal *cy pres* rule controlling "charitable" corporations such as the petitioner, within the wider meaning of that term, as to prompt the directors to procure a declaratory judgment proscribing disposition of the petitioner's assets to its members, *Attinson* v. *Consumer-Farmer Milk Cooperative, Inc.*, 94 N. Y. S. 2d 891.

The Court of Appeals placed its decision on the ground that a substantial portion of the income of the petitioner inured to the benefit of its members in the form of patronage dividends, and therefore the petitioner was not "operated exclusively for the promotion of social welfare", but was in fact "organized for profit" (R. 39-41).

Specification of Error to Be Urged.

The Court of Appeals erred in denying exemption to the petitioner on the basis of this novel rule of law: the payment of deductible patronage dividends by a cooperative corporation is a profit distribution, within the prohibition of I.R.C. §101(8) relating to corporations "organized for profit"; and so the corporation cannot qualify as one "operated exclusively for the promotion of social welfare".

Reasons for Granting the Writ.

1. The decision of the Court of Appeals is in direct and acknowledged conflict with the decision of the Court of Appeals for the Sixth Circuit in *United States* v. *Pickwick Electric Membership Corporation*, 158 F. 2d 272 (1946), in its denial of exemption to a cooperative civic organization because of the distribution of patronage dividends.

2. The question decided below, as to the "profit" character of patronage dividends, is a fundamental question of tax law which has not been, but should be, settled by this Court. This question affects not only the exemption of cooperatives under I.R.C. §101(8), but also the deduction of patronage dividends by cooperatives under I.R.C. §23.

3. The decision of the court below on the "profit" character of patronage dividends is so great a departure from the long-standing Treasury rule, and the numerous cases which have approved it, as to require review by this Court.

4. The question of the effect of commercial activities on the right to exemption under I.R.C. §101(8) is an important question which has not been, but should be, settled by this Court.

5. Independent of the importance from the standpoint of the tax law of the questions stated above, review by this Court of the decision below is warranted because it threatens the continuance of the petitioner and similar cooperative social ventures, as well as cooperatives of all kinds.

Wherefore it is respectfully requested that a writ of certiorari be issued to the Court of Appeals for the Second Circuit.

Respectfully submitted,

MARK H. JOHNSON,
Counsel for Petitioner.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1950.

No. .....

CONSUMER-FARMER MILK COOPERATIVE, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Introductory Statement.

The nature of this action and the principal facts have been outlined in the petition and need not be restated here.

Specification of Error to Be Urged.

The Court of Appeals erred in denying exemption to the petitioner on the basis of this novel rule of law: the payment of deductible patronage dividends by a cooperative corporation is a profit distribution, within the prohibition of I. R. C. §101(8) relating to corporations "organized for profit"; and so the corporation cannot qualify as one

"operated exclusively for the promotion of social welfare".

Argument.

This case is but a further instance of the recent attacks on cooperatives because of their favored tax status. It raises a fundamental question of taxation affecting cooperatives generally. The specific issue involves the effect of patronage dividends on exemption of civic organizations under I. R. C. §101(8). The deductibility of such dividends under I. R. C. §23 (a question on which this Court has never passed) is not directly in issue, because the Commissioner has allowed the deduction to the taxpayer here; but it is collaterally involved because, if a patronage dividend is finally decided to be a profit distribution for purposes of §101(8), the theoretical justification for its deduction by a cooperative under §23 collapses. Conversely, of course, legal considerations supporting the §23 deduction also support the exemption under §101(8).

The holding of the Court of Appeals on the exemption issue, that patronage dividends militate against an organization's being "operated exclusively for the promotion of social welfare", is directly contrary to the rule adopted by the Sixth Circuit in *U. S.* v. *Pickwick Electric Membership Corporation*, 158 F. 2d 272, as the court below expressly acknowledged in "respectfully declining to follow" *Pickwick* (R. 42). That case concerned a cooperative nonprofit, non-stock corporation organized by Tennessee residents to bring electricity into rural districts and to furnish electricity at more reasonable rates than were charged by private companies. The cooperative sold electricity at a profit to members and also to non-members, but at higher rates. The by-laws provided that all revenues in excess of expenses, debt retirement, and necessary reserves be distributed to the members as patronage refunds, or by way

of rate reductions, or both. The case is almost indistinguishable from the case at bar, except that in the taxable year before the court resort was had to rate reductions, rather than to refunds; but the court viewed consumer dividends as an "indirect form of reduced rates".

To an argument identical to that adopted by the Court of Appeals below, the Sixth Circuit said:

> "The Government's contention is that it was not operated exclusively for that purpose (social welfare) in that its earned income inured to the benefit of its members in the form of patronage refunds or reduced rates. Patronage refunds are in substance an indirect form of reduced rates * * * Benefits through the form of rate reductions are not dividends on investments any more than any other reduction in the cost of living can be called such. Such a benefit is the result of the successful promotion of social welfare by the company. The participation on the part of the members in the benefits of such social welfare does not mean that the operations are for their individual benefit instead of for the benefit of the community * * * Non-members had the right to become members on a non-discriminatory basis and share alike in the benefits provided by the company." (Omissions relate only to the court's discussion of cases it followed or distinguished.)

In reaching a contrary result in the instant case, the court below was compelled to characterize the patronage dividends as "profit" distributions, notwithstanding its recognition of the judicially supported Treasury rule treating them otherwise for purposes of deduction under I. R. C. §23. See G. C. M. 17895, Cum. Bull. 1937-1, 56; I. T. 3208, Cum. Bull. 1938-2, 127; *Fruit Growers Supply Co.* v. *Com'r*, 21 B. T. A. 315, aff'd 56 F. 2d 90; *Midland Coop. Whole-*

sale, 44 B. T. A. 824; *United Coops. Inc.*, 4 T. C. 93; *Farmers Coop. Co.* v. *Birmingham*, 86 F. Supp. 201. The court did not criticize the rule under §23, but rather found it not "persuasive" under §101(8). In other words, in the view of the court, a taxpayer may be "organized for profit" in some restricted §101(8) sense, though not otherwise capable of being so regarded. The court obviously erred in treating §§23 and 101(8) as mutually exclusive on the profit issue. The tax law does not allow deduction of patronage dividends by cooperatives under I. R. C. §23 out of any narrow view of "profits". The theoretical justification for the deduction is stated by the Treasury as follows:

> "The practice is based on the theory that such amounts in reality represent a reduction in cost to the patron of goods purchased by him through the corporation or an additional consideration due the patron for goods sold by him through the corporation." I. T. 3208, *supra*.

If a patronage dividend is a true price adjustment, this would also foreclose a charge that a taxpayer is "organized for profit" for the purposes of §101(8), because such an adjustment could not detract from the taxpayer's promotion of social welfare.

It is submitted that the court below, in burdening the phrase "organized for profit" with a special meaning for §101(8), bent the phrase out of shape in preference to acknowledging the real conflict between its decision and the "patronage dividend" precedents cited above.

If the writ of certiorari is granted, the petitioner will argue that a cooperative is not "organized for profit" in the sense of pecuniary profit for its members, either for the purposes of §101(8) or of §23, solely by reason of the distribution of patronage dividends. The element of departure from ordinary corporate dividends is found in the

fact that the financial gain is enjoyed by the members in exact proportion to the business transacted with the cooperative during any period, rather than in proportion to capital contributed to the corporation. This difference of economic principle governing the allocation of income is fundamental. It is not merely a technique to distribute to the members the profits earned by the cooperative generally, only substituting volume of patronage for number of shares owned.

The consumer and farmer dividends paid by the petitioner are themselves good illustrations of the nonprofit character of patronage dividends. Annual declaration of such dividends is obligatory upon the petitioner, by reason of its by-laws and directors' resolutions—a fact often noted in the cases sustaining deduction for patronage dividends. See *Fruit Growers Supply Co., supra; Midland Cooperative Wholesale, supra; United Cooperatives, Inc., supra.* The by-laws leave determination of the actual amount of dividends to the directors, but require them to be uniform in direct proportion to business done with each consumer or farmer member, and in the case of consumer dividends, provide that "such dividends shall not exceed the difference between the cost of producing these purchases and their selling price". It is further required that consumer dividends be declared in twice the amount of farmer dividends. Being thus related to consumer dividends, the farmer's dividend too can only be derived from the spread between the cost and selling price of the units furnished by such farmer; and no farmer can share in the profit made by the petitioner on the sale of units supplied by any other farmer. A directors' resolution effective for the taxable year authorized farmer dividends of 7½ cents per 100 quarts of milk sold through the petitioner, and consumer dividends of 15 cents per 100 quarts of milk purchased from the petitioner.

We anticipate that the respondent will argue (as he has before), in opposing the granting of this writ, that even if the patronage dividend is not a disqualifying profit distribution, the petitioner is nevertheless "organized for profit" solely by virtue of the fact that it was engaged in a business ordinarily carried on for profit, and itself made a profit in its operations. Both of the lower courts have rejected this as a basis for denying exemption to the petitioner, as have all the courts which have considered the question in relation to exemption under §101(8). See *Garden Homes Co.* v. *Com'r*, 64 F. 2d 593; *Hanover Improvement Society, Inc.* v. *Gagne*, 92 F. 2d 888; *Debs Memorial Radio Fund, Inc.* v. *Com'r*, 148 F. 2d 948; *U. S.* v. *Pickwick Electric Membership Corporation*, 158 F. 2d 272.

This has also been the rule of the cases under I. R. C. §101(6), relating to the exemption for charitable and educational corporations. *Roche's Beach Inc.* v. *Com'r*, 96 F. 2d 776; *Com'r* v. *Battle Creek, Inc.*, 126 F. 2d 405; *Bohemian Gymnastic Association Sokol* v. *Higgins*, 147 F. 2d 774; *Com'r* v. *Orton Ceramic Foundation*, 173 F. 2d 483; *Willingham* v. *Home Oil Mill*, 181 F. 2d 9, cert. den. 340 U. S. 852; *Unity School of Christianity*, 4 B. T. A. 61; *Sand Springs Home*, 6 B. T. A. 198. Two recent cases do not represent repudiations of the basic rule, but involve the introduction of novel interpretations of subdivision (6) of §101 on facts and statutory language which are entirely absent from the present case. See *Mueller* v. *Com'r*, 14 T. C. 922, appeal pending C. A. 3rd (involving the problem of a "feeder" organization); *Universal Oil Products Co.* v. *Campbell*, 181 F. 2d 451, cert. den. 340 U. S. 850 (involving the problem of a corporation originally organized for private profit).

By the Revenue Act of 1950 Congress expressly provided for the taxation of the business income of certain organizations exempt from tax under §101(6), thus modi-

fying the rule of the above cases prospectively for taxable years beginning after December 31, 1950. See I. R. C. §421, added by Rev. Act of 1950 §301(a). However, the new legislation is deliberately inapplicable to organizations exempt under subdivision (8) of §101, *inter alia*. Therefore, the problem is a continuing one for §101(8) organizations, and if the anticipated argument of the respondent is any indication of uncertainty in the law, this Court may wish to settle this question by granting the writ.

Conclusion.

Because the decision of the Court of Appeals is in direct conflict with the decision in another circuit on the identical issue, and because the questions decided below are fundamental to the taxation of cooperatives as well as civic organizations and have not been passed upon by this Court, and because the decision below represents a substantial departure from precedent, it is respectfully requested that certiorari be granted.

Respectfully submitted,

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COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

OPINIONS BELOW.

The findings of fact and opinion of the Tax Court (R. 3-18) are reported at 13 T. C. 150. The opinion of the Court of Appeals (R. 36-42) is reported at 186 F. 2d 68.

JURISDICTION.

The judgment of the Court of Appeals was entered December 27, 1950. (R. 43.) The petition

for certiorari was filed March 23, 1951. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED.

Whether the taxpayer is exempt from taxation under Section 101(8) of the Internal Revenue Code, which grants tax-exempt status to civic leagues or organizations "not organized for profit but operated exclusively for the promotion of social welfare."

STATUTE AND REGULATIONS INVOLVED.

Internal Revenue Code:

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

> The following organizations shall be exempt from taxation under this chapter—
>
> * * * * * *
>
> (8) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes;
>
> * * * * * *
>
> (12) Farmers', fruit growers', or like associations organized and operated on a cooperative basis (a) for the purpose of market-

ing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (b) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses. * * *

* * * * * *

(26 U.S.C. 1946 ed., Sec. 101.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.101(8)-1 [As amended by T. D. 5458, 1945 Cum. Bull. 45]. *Civic Leagues and Local Associations of Employees.*—Civic leagues entitled to exemption under section 101(8) comprise those not organized for profit but operated exclusively for purposes beneficial to the community as a whole, and, in general, include organizations engaged in promoting the welfare of mankind, other than organizations comprehended within section 101(6). Certain local associations of employees are also expressly entitled to exemption under section 101(8). The Internal Revenue Code prescribes as conditions to exemption (1) that the membership of such an association be limited to the employees of a designated person or persons in a particular municipality, and (2) that the net earnings of the association be devoted exclusively to charitable, educational, or rec-

reational purposes. See section 29.101(6)-1 with reference to the meaning of "charitable" and "educational" and section 29.101(10)-1 as to the meaning of "local" as used in section 101.

Sec. 29.101(12)-1 [As amended by T. D. 5458, *supra*]. *Farmers' Cooperative Marketing and Purchasing Associations.*—(a) Cooperative associations engaged in the marketing of farm products for farmers, fruit growers, livestock growers, dairymen, etc., and turning back to the producers the proceeds of the sales of their products, less the necessary operating expenses, on the basis of the products furnished by them, are exempt from income tax. For instance, cooperative dairy companies which are engaged in collecting milk and disposing of it or the products thereof and distributing the proceeds, less necessary operating expenses, among the producers upon the basis of the quantity of milk or of butter fat in the milk furnished by such producers, are exempt from the tax. If the proceeds of the business are distributed in any other way than on such a proportionate basis, the association does not meet the requirements of the Internal Revenue Code and is not exempt. In other words, nonmember patrons must be treated the same as members in so far as the distribution of patronage dividends is concerned, that is, if products are marketed for nonmember producers, the proceeds of the sale, less necessary operating expenses, must be returned to the patrons from the sale of whose goods such pro-

ceeds result, whether or not such patrons are members of the association. * * *

STATEMENT.

The facts, which are not in dispute, were found by the Tax Court as follows:

Taxpayer was organized as a non-stock producer-consumers' cooperative. Although its purpose in organizing was stated in the certificate of incorporation as being (R. 4): "for mutual help, not conducted for profit," it was organized to return a reasonable profit which, after reserves, was to be distributed to the consumers and farmers as patronage dividends and to be used for educational purposes. (R. 6.)

Only a small percentage of the patronage dividends declared for consumers is paid because of the small number of consumers who apply for dividend payments. In accordance with taxpayer's by-laws, the unclaimed consumer dividends are transferred to the general reserve fund after one year from the date of declaration. Farmer members, however, have received all dividends declared for them. Taxpayer's consumer dividend record from 1938 through the taxable year in question shows $39,922.53 set aside for consumer dividends during the six-year period and only $3,050.25 paid to consumers during that period. (R. 7.)

Taxpayer's by-laws may be amended by its members. Three percent of the members, or 300 mem-

bers if the membership exceeds 10,000, constitutes a quorum. (R. 7.)

Taxpayer's operations consist of handling and distributing milk from its two country plants through some 500 distributing centers to retail selling points throughout New York City. During the taxable year ended September 30, 1943, taxpayer sold fifteen million quarts of milk. (R. 8.)

Taxpayer owns substantial assets, a large portion of which were obtained by taxpayer by appropriating unredeemed consumer dividends which had been converted into the general reserve fund. (R. 8.)

Taxpayer reported a gross income of $370,133.90 during the taxable year involved. (R. 8.)

Through its officers, taxpayer has sought to improve the milk industry for the benefit of both the farmers and consumers. (R. 9-12.)

For the years ended September 30, 1938, through September 30, 1942, taxpayer set aside for cooperative education a total of $1,015.23, or an average of approximately $200 a year. Thereafter it added no funds to this account. (R. 12.)

For the taxable year ended September 30, 1943, taxpayer deducted from its gross income the sum of $25,920.88 for declared rebates or patronage dividends to consumer patrons. Only $871.05 of the total amount so declared was paid. The remainder lapsed as dividends and was converted into taxpayer's general reserve fund. (R. 12.)

ARGUMENT.

On these facts the Tax Court and the Court of Appeals were clearly correct in denying taxpayer a tax-exempt status under Section 101(8), *supra,* which exempts from taxation "civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare". The decision below raises no novel or substantial question of law warranting review, and involves no conflict of decisions. Contrary to taxpayer's assertion, the case presents no issues as to the status of cooperatives generally under the revenue laws, since the taxpayer concededly does not qualify as a tax-exempt cooperative under Section 101(12),[1] the general provision dealing with cooperatives.

The appellate court's conclusion was predicated primarily on the taxpayer's inability to meet the statutory condition that it be operated exclusively for the promotion of social welfare, since the taxpayer's earnings have been consistently distributed to its producer members, who were its only

[1] It is conceded that taxpayer cannot qualify under Section 101(12), *supra,* for the following reasons: The taxpayer is a consumer and producer cooperative whereas Section 101(12) grants exempt status only to producer cooperatives. The taxpayer does not turn back all the profits of sales less the necessary marketing expenses as is required for exempt status under Section 101(12). Moreover, the taxpayer's earnings are not distributed to members and nonmembers alike as the Regulations promulgated under Section 101(12) require. Section 29.101(12)-1 of Treasury Regulations 111, *supra.*

substantial beneficiaries. Taxpayer is able to meet none of the statutory requisites for tax exempt status, since, on the facts found by the Tax Court, it is not a civic league, it was in fact organized for profit, and was operated primarily for the financial gain of its individual producer members, rather than for the promotion of social welfare.

An analysis of taxpayer's activities by the court below led it to the conclusion that taxpayer, which was engaged in the vigorous competitive sale of milk, had not only failed to meet the requirement that it be operated exclusively[2] for the promotion of social welfare, but that, on the contrary, the welfare of its individual producer members was the real concern of the taxpayer; for, while the taxpayer had consistently emphasized its charitable

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[2] This Court has held in *Better Business Bureau* v. *United States*, 326 U. S. 279, that the use of the word "exclusively" in a context such as this cannot be loosely construed. While in the *Better Business Bureau* case the question involved the construction of Section 811(b)(8) of the Social Security Act, c. 531, 49 Stat. 620, exempting from Social Security taxes organizations "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes • • •," the language of Section 811(b)(8) and the nature of the problem presented make it clear that with respect to the interpretation of the word "exclusively," this case is governed by the *Better Business Bureau* case. Since Section 811(b) provided that the organization had to be devoted to educational purposes "exclusively," this Court held (p. 283) that "the presence of a single noneducational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes."

and educational activities, the principal destination of its profits was apparently the pockets of its producer members. Only a relatively small portion of taxpayer's profits was devoted to educational or other civic purposes. As the Court of Appeals observed, the controlling purpose was "primarily to benefit the taxpayer's membership economically, and only incidentally to further larger public welfare * * *." (R. 40-41.)[3]

The same facts which formed the basis of the holding by the court below that taxpayer was not operated exclusively for the promotion of social welfare impel the conclusion that taxpayer is not, as required by the statute, a civic league. Although the statute contains no definition of civic league, and the court below considered it unnecessary to determine whether taxpayer was a "civic league," the court did observe that the Regulations

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[3] Taxpayer's by-laws direct the board of directors to "apportion the net earnings from the operation of the business" for the following purposes: (a) at least 10 percent shall be set aside as a general reserve fund; (b) at least 5 percent shall be used for cooperative education; (c) special reserve funds may be established; and (d) patronage dividends shall be payable to consumer members and to producer members (farmers) in the ratio of two to one. The sums set aside for cooperative education in each of the fiscal years 1939 to 1942 were insignificant; in 1939, $350.81; in 1940, $346.82; in 1941, $170.58; in 1942, $147.02. Thereafter taxpayer added no funds to this account, for the reason, as stated in its brief on appeal, that it decided to charge education expenses to general operating expenses. The Tax Court made no finding as to the amount of educational expenses during the taxable year and the record contains no figures as to this.

have construed the term civic league to include "organizations engaged in promoting the welfare of mankind";[4] and that insofar as the operations of the taxpayer were directed to serving the economic welfare of its members—one of the purposes stated in its by-laws—its activities had a much more limited objective than the promotion of the welfare of mankind.[5] Taxpayer, an organization of producers engaged in the vigorous and competitive sale of milk at a profit consistently distributed to its producer members, clearly meets none of the requisites of a "civic league".

Finally, taxpayer does not meet the statutory requirement that it not be organized for profit. Despite the statement in taxpayer's certificate of incorporation that it was not conducted for profit, the Tax Court found as a fact, on the basis of testimony of taxpayer's own witness (R. 13),[6] that taxpayer was organized for a profit-making purpose. The Court of Appeals noted that taxpayer competed vigorously with other milk distributors,

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[4] Treasury Regulations 111, Section 29.101(8)-1, *supra*.

[5] See *Amalgamated Housing Corp.* v. *Commissioner*, 37 B.T.A. 817, affirmed, 108 F. 2d 1010 (C. A. 2d), holding that an organization established to construct a low-cost housing project was not a civic league.

[6] Testimony of Helen Hall:

> Q. It was not your idea that milk should be sold to the public without a profit being made?
>
> A. No.
>
> Q. It was only to have a reasonable profit?
>
> A. That is right.

and that it has been highly successful in making a profit, as evidenced by the fact that, while it started in 1938 with a borrowed capital of $6,000, its balance sheet as of September 30, 1943, showed assets totalling more than $138,000, and a net worth of more than $15,000. (R. 38.)[7] In the language of this Court, "The commercial hue permeating petitioner's organization" (*Better Business Bureau* v. *United States*, 326 U. S. 279, 283), is reflected both in its corporate activities and in the use to which the profits derived from its activities were devoted.

There is no merit in taxpayer's contention that it is entitled to tax exempt status by virtue of the fact that it was obligated to or did, in fact, distribute a portion of its earnings to its members, and that taxpayer was permitted by the Commissioner to deduct from its gross income the rebate distributions actually paid. The Commissioner's action in allowing such deductions is not relevant here, and cannot operate to change the status of taxpayer for the purposes of Section 101(8). While the administrative practice has been to allow the deduction of such distributions even where the organization could not qualify under

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[7] Cf. *Better Business Bureau* v. *United States*, 326 U. S. 279; *Trinidad* v. *Sagrada Orden*, 263 U. S. 578; *West Side Tennis Club* v. *Commissioner*, 111 F. 2d 6 (C. A. 2d), certiorari denied, 311 U. S. 674; *Jockey Club* v. *Helvering*, 76 F. 2d 597 (C. A. 2d); *Northwestern Jobbers' Credit Bureau* v. *Commissioner*, 37 F. 2d 880 (C. A. 8th).

the exempting provision, such a practice has never been interpreted to render the organization tax-exempt or to remove from the impact of federal taxation the undistributed earnings. See *Co-Operative Oil Ass'n* v. *Commissioner,* 115 F. 2d 666 (C. A. 9).

There is no conflict with *United States* v. *Pickwick Electric Membership Corp.,* 158 F. 2d 272 (C. A. 6). In that case the taxpayer, a Tennessee electricity membership corporation, organized to provide low cost rural electrification, was not organized for the purpose of earning an ultimate profit. As the Court of Appeals there observed, while it was true that it did collect sums in slight excess of its expenditures, this so-called profit was only a tentative one closely related to the readjustment of rates and there was no intention to make a profit over a long period of time, but merely to maintain a margin of safety. The intention is obviously different here where the taxpayer was organized and operated to earn a substantial profit on its sales. It is also significant that in the *Pickwick Electric* case, patronage refunds, which were actually in the nature of rate adjustments, inured to the benefit of citizens of the community so that the court was inclined to hold that this itself constituted the promotion of social welfare, but here the principal beneficiaries of taxpayer's efficient operations were its producer members. Finally, in the *Pickwick Electric* case the Court of Appeals observed that there were no cash distribu-

tions involved.[8] Each case thus turned on its own facts.

CONCLUSION.

The petition for certiorari should be denied.

Respectfully submitted,

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April, 1951.

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[8] Moreover, in that case there was no showing that the Pickwick Electric Membership Corporation was engaged in vigorous competition with other companies. No doubt the corporation was organized, at least in part, to service communities which lacked electricity. Furthermore, its business with non-members was expressly limited.

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